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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of )

)  
Simplification of the )  
Depreciation Prescription )  
Process )

CC Docket No. 92-296

AT&T COMMENTS

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### SUMMARY

AT&T supports the Commission's effort to reduce unnecessarily burdensome regulation by simplifying the determination of depreciation expense. Of the four alternatives proposed in the Depreciation NPRM to accomplish this objective, the "price cap carrier option" is clearly most appropriate for a carrier such as AT&T whose capped interstate rates are unaffected by the level of its depreciation expense and who is subject to vigorous, pervasive competition. Accordingly, the Commission should promptly adopt the proposed price cap carrier option for prescribing AT&T's depreciation expense.

The Commission should not, however, adopt this methodology to determine depreciation expenses for local exchange carriers ("LECs") subject to price cap regulation because, unlike AT&T, those carriers' prices are still linked to the prescribed amount of their depreciation costs, and the LECs' access services are not now subject to pervasive competition. Instead, the Commission should select from among the Depreciation NPRM's other proposed alternatives the simplification method that is least costly and burdensome to implement and that best protects customers from undue price increases resulting from the LECs' increased control over their regulated depreciation rates.

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AT&T COMMENTS

Pursuant to Section 1.415 of the Commission's Rules, 47 C.F.R. § 1.415, American Telephone and Telegraph Company ("AT&T") submits these comments on the Depreciation NPRM,<sup>1</sup> which proposes to simplify the procedures and reduce the costs associated with the Commission's depreciation prescription process.

Background Statement

Pursuant to Section 220(b) of the Communications Act, the Commission currently prescribes depreciation rates for 33 LECs (who represent the bulk of the local exchange industry), and two interexchange carriers, AT&T and Alascom.<sup>2</sup> Under the Commission's

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<sup>1</sup> Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Notice of Proposed Rulemaking, FCC 92-537, released December 29, 1992 ("Depreciation NPRM").

<sup>2</sup> See Depreciation NPRM, ¶ 2; 47 U.S.C. § 220(b). The Commission has also prescribed amortization amounts, in lieu of depreciation rates, to resolve certain depreciation accounting issues. See, e.g., Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers, 3 FCC Rcd. 984 (1988).

current procedures, carriers periodically submit lengthy, detailed depreciation studies relating to their recent plant retirements and planned future plant retirements to substantiate their estimates of the basic factors underlying their depreciation computations.<sup>3</sup> Id., ¶ 6. These estimates are then independently analyzed by the Common Carrier Bureau, which forwards its preliminary depreciation rate proposals to state public utility commissions for their evaluation.<sup>4</sup> The preliminary rate proposals are then discussed in meetings between the Bureau and the state commissions prior to formal filing by the carriers of their proposed depreciation rates, which are then placed on public notice by the Commission.<sup>5</sup>

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<sup>3</sup> The three basic factors in the depreciation calculation are future net salvage ("FNS") (the estimated gross salvage of plant, less any estimated cost of removal); projection life (the life expectancy of new additions to plant); and the survivor curve (the expected retirement distribution of plant in an account over time). Projection life and the survivor curve compose the average remaining life ("ARL") parameter in the depreciation formula. Depreciation NPRM, ¶ 4.

<sup>4</sup> This coordination with the states is carried out pursuant to Section 220(i) of the Communications Act, 47 U.S.C. § 220(i), which requires the Commission before prescribing depreciation rates to "notify each state commission having jurisdiction" over an affected carrier and to give the state commission a "reasonable opportunity" to present its views for consideration by the Commission.

<sup>5</sup> See, e.g., Prescription of Revised Percentages of Depreciation (Bell Telephone Co. of Pennsylvania, et al.), FCC 93-40, Memorandum Opinion and Order, released

As the Depreciation NPRM correctly acknowledges (§ 8), requiring carriers to provide such substantiation for their individual depreciation computations is no longer warranted in the current regulatory and market environment, and imposes undue burdens on both the agency and the affected carriers. As indicated in the Depreciation NPRM (§ 6), the burden on the Commission's resources to analyze and evaluate the carriers' detailed depreciation studies is clearly substantial. Moreover, carrier compliance with these unnecessary procedures is costly. AT&T estimates that its expense of providing depreciation studies to the Commission is at least \$1.5 million annually.<sup>6</sup> The Depreciation NPRM (§ 8 and n.9) also cites estimates that the cost to the LECs of

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(Footnote continued from previous page)

January 15, 1993, ¶ 3 (describing stages in the Commission's depreciation prescription process).

<sup>6</sup> None of AT&T's interexchange competitors is required to incur this cost. Moreover, these transaction costs are only one of the burdens imposed upon AT&T under the current depreciation prescription process. As AT&T has recently shown, the current process has created a significant discrepancy between AT&T's regulated depreciation expense and reserves and the amounts of these expenses reflected in its financial reports, thereby distorting its condition for regulatory purposes. Accordingly, AT&T has requested a waiver to compute its MR depreciation expense in conformity with depreciation rates used in its financial reports. See Public Notice, DA 93-133, released February 11, 1993.

compiling and supplying these depreciation data is between \$35 and \$50 million annually.

In lieu of the current procedure, the Commission has suggested four alternative methods to simplify the determination of depreciation expense. Three of these options replace the provision of carrier-specific depreciation studies with a system of Commission-prescribed ranges for permissible depreciation rates or for factors underlying the depreciation calculation.<sup>7</sup> As a fourth alternative, the Commission proposes to allow carriers subject to price cap regulation to file requested depreciation rates with the Commission without supporting data other than the changes in depreciation expense that the proposed rates would produce. As the Depreciation NPRM (§ 41) explicitly recognizes, this procedure "would essentially eliminate all of the steps the Commission now takes to analyze the carriers proposed depreciation rates." The Commission would continue, however, to place the proposed

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<sup>7</sup> See Depreciation NPRM, §§ 9, 13-25 ("base factor range option" establishing allowable ranges to be selected by carriers for factors of the depreciation formula); id., §§ 10, 26-32 ("depreciation rate range option" establishing a permissible range of depreciation rates to be selected by carriers for applicable plant accounts); id., §§ 11, 33-39 (establishing depreciation schedules for each plant account, which carriers would apply to their investments).

depreciation rates on public notice and to prescribe the rates ultimately used by the carrier.<sup>8</sup>

I. THE PROPOSED PRICE CAP CARRIER OPTION IS MOST APPROPRIATE FOR PRESCRIPTION OF AT&T'S DEPRECIATION EXPENSE.

AT&T strongly urges the Commission expeditiously to implement the Depreciation NPRM's "price cap carrier option" for prescribing AT&T's depreciation expense. As the Depreciation NPRM itself explains (§ 7), the current depreciation prescription methodology was developed under a rate-of-return scheme of regulation, in which the calculation of depreciation impacted directly on AT&T's authorized revenue requirement and, hence, its rates. Almost four years ago, however, the Commission adopted incentive regulation in lieu of a prescribed rate

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<sup>8</sup> Id., §§ 12, 40-42. The proposed price cap carrier process for computing AT&T's depreciation expense is fully consistent with the Commission's notification obligations to state commissions under Section 220(i) of the Communications Act. Section 220(i) requires the Commission to "notify each state commission" having jurisdiction over a carrier proposing revised depreciation rates, and to "give reasonable opportunity" for the state regulators to present their views on those proposed rates for the Commission's consideration. The statute does not, however, prescribe any particular method for the Commission to implement these obligations. Accordingly, the Commission can rely on the notice and comment process to obtain input from state commissions on AT&T's proposed depreciation rates under the price cap carrier option.



of return for AT&T's interstate services.<sup>9</sup> Under this "price cap" scheme, AT&T's rates are no longer based on changes in its costs, including depreciation. Moreover, as the Depreciation NPRM points out (§ 23), price cap rates are unchanged even by Commission-prescribed changes in AT&T's depreciation rates.

In light of this endogenous treatment of depreciation expense (which the Commission's proposals in this proceeding would correctly continue), neither the Commission's current procedure for computing AT&T's depreciation expense (which requires detailed studies to substantiate its proposed depreciation rates) nor the three other simplified methods proposed in the Depreciation NPRM make any further logical sense for the Commission's regulation of AT&T.

This fact is underscored by the Commission's own report in October 1990 to the House Subcommittee on Telecommunications and Finance, which noted that AT&T's rates for all three "baskets" of residential and business services declined significantly in the first year of price cap regulation despite increases in depreciation expenses granted in 1989. As the Commission stated there, the increased depreciation "did not affect AT&T's

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<sup>9</sup> Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order, 4 FCC Rcd. 2873 (1989) ("AT&T Price Cap Order").

capped prices; under the price cap plan, the company had to absorb these costs itself."<sup>10</sup> The Commission thus has estimated that during the first three and one-half years of price cap regulation, AT&T's rates declined by at least \$1.5 billion, even though AT&T was granted over \$2 billion in increased depreciation expenses during that same period.<sup>11</sup>

Moreover, apart from the constraints imposed by price cap regulation, the highly competitive nature of the interexchange telecommunications marketplace determines the level of AT&T's service rates. The Commission has already concluded that outbound business services in price cap Basket 3 are competitive, and has therefore subjected those rates to streamlined regulation.<sup>12</sup> Similarly, the Commission has concluded

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<sup>10</sup> See "AT&T's Performance Under Price Cap Regulation," Report to the Subcomm. on Telecommunications and Finance, Comm. on Energy and Commerce, U.S. House of Representatives (Oct. 1990) at 18 (emphasis supplied).

<sup>11</sup> Common Carrier Bureau, Price Cap Performance Review of AT&T, CC Docket No. 92-134 (Sept. 1, 1992), at Charts 2, 3.

<sup>12</sup> See Competition in the Interstate Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd. 5880 (1991) ("IXC Rulemaking Order"), recon., 6 FCC Rcd. 7569 (1991), further recon., 7 FCC Rcd. 2677 (1992). In that proceeding, the Commission explicitly found that the excess capacity of AT&T's competitors, and the demonstrated willingness of customers to switch carriers, "constrain[s] AT&T's market behavior and inhibit[s] it from charging excessive rates." IXC Rulemaking Order, 6 FCC Rcd. at 5887-5889.

that inbound services (price cap Basket 2) should be streamlined as soon as 800 number portability is implemented on May 1, 1993.<sup>13</sup> In light of the indisputable regulatory and marketplace facts described above, the Commission should move promptly to replace its current method of determining AT&T's depreciation expense with the "price cap carrier option" described in the Depreciation NPRM.

II. THE PRICE CAP CARRIER OPTION IS NOT APPROPRIATE FOR PRESCRIPTION OF THE LECS' DEPRECIATION EXPENSES.

AT&T also endorses the Commission's efforts to simplify depreciation prescription procedures with respect to the LECs. However, as a threshold matter the Commission should rule out adopting the price cap carrier option for LECs subject to price cap regulation.

In marked contrast to the Commission's incentive regulation of AT&T, changes in the LECs' level of depreciation expenses can directly affect the level of those carriers' rates to customers. This is because the LEC price cap plan includes a sharing and adjustment mechanism that links their realized rates of return (which are based, in part, on Commission-prescribed

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<sup>13</sup> See id. at 5905 & n.233. In addition, as AT&T has demonstrated in the Price Cap Review proceeding, all of its price capped services are in fact substantially competitive, and should therefore be subject to the same regulatory treatment as services of AT&T's competitors.

depreciation) to allowable prices. Thus, LECs that achieve earnings in excess of 12.25 percent (or, if the carrier selects a higher productivity offset, 13.25 percent) are required to share any additional earnings in part or in whole with their access customers in the form of forward-looking rate reductions. Conversely, price cap LECs that earn below 10.25 percent are permitted temporarily to increase their price to customers.

The direct linkage between the LEC's realized earnings and its prospective rates could create an economic incentive for some carriers to manipulate their proposed depreciation rates either to mitigate or eliminate entirely their sharing obligation under the Commission's price cap plan, or alternatively to obtain a "low end adjustment" to increase rates. In view of this potential risk, the price cap carrier option is especially inappropriate for LECs because those carriers are not subject to intense and pervasive competition.<sup>14</sup> Throughout its price cap proceedings, the Commission has

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<sup>14</sup> In adopting price cap regulation for the LECs, the Commission found that "there is little competition for LEC access services", and that "the LECs are subject to less competition than AT&T." See 4 FCC Rcd. at 3148 (¶¶ 572, 594). Even now, four years later, the Depreciation NPRM (¶ 8) still contrasts the "significant competition" evident in the interexchange marketplace with the "emerging competition" only now appearing in local exchange markets.

sought to avoid carrier influence over the operation of its plan that could adversely affect access ratepayers.<sup>15</sup> Because of the threat posed here to the successful implementation of its regulatory regime for the LECs, the Commission should conclude that the price cap carrier option proposed in the Depreciation NPRM is not appropriate for establishing the depreciation expense of these carriers.

Instead, to avoid unwarranted rate increases, the Commission should adopt a simplified depreciation methodology for the LECs (whether they are subject to rate of return or price cap regulations) which limits the latitude of those carriers to determine their own depreciation rates (and, hence, their prices). In AT&T's view, any of the remaining simplification options proposed in the Depreciation NPRM could satisfy this objective if implemented with due regard for ratepayer interests. The Commission should therefore adopt whichever of the remaining three alternatives best furthers this goal and is also least costly and burdensome to the affected carriers.

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<sup>15</sup> See, e.g., Policy and Rules for Rates of Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd. 6786, 6792-93 (1991) (¶¶ 50, 54) (in selecting inflation adjustment factor, Commission sought index "that the LECs could not influence or manipulate" and rejected industry-specific cost index that "would be vulnerable to manipulation by individual LECs or groups of LECs").

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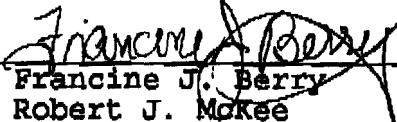
CONCLUSION

For the reasons stated above, the Commission should promptly adopt the price cap carrier option to prescribe the depreciation rates of AT&T. However, because of the different regulatory and competitive environment in which LECs operate, the Commission should decline to adopt this option for LECs subject to price cap regulation.

Respectfully submitted,

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March 10, 1993

CERTIFICATE OF SERVICE

I, Ann Marie Abrahamson, certify that on this 10th day of March, 1993, a true copy of the foregoing "AT&T Comments" was served, by hand delivery, upon the following parties.

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